The Phase I Decision authorized contracts for "appropriate" tariffed services, including vertical services,[55] Centrex and CentraNet services other than the Centrex or CentraNet station loop, and High Speed Digital Private Line service. That list should now be expanded to include all private line, MTS, WATS, and 800 services and all other Category II services as defined in this order, including PBX trunks and Centrex or CentraNet access lines. Contracts will be permitted for all Category II and III LEC services.

Allowing contracts to include Category I services at other than tariff rates could encourage rate and service discrimination in contravention of § 453 of the PU Code. Contracts may include Category I services only if they are priced not lower than the tariff rate. However, certain Category I services may not be included in contracts under any circumstances. We affirm our prior decision not to allow contracting for residential subscriber service, business basic exchange lines, ZUM, local usage, and the access line portion of semipublic telephone service.

2. Contract Price Floors

GTEC and DRA agree that the Commission's adopted cost standards, including the imputation tests for bundled services containing monopoly building blocks, should constitute the price floor for contracts. The appropriate basic cost standard for contracts is the LRIC of providing the service under contract, but the parties suggest that the LRIC could be calculated by either of two methods: statewide average LRIC for the service (which we refer to as the servicewide LRIC) or customer-specific LRIC. Pacific asserts that the price floor for contract services should

55 Vertical services were identified in the Phase I settlement as call waiting, call forwarding, speed calling, call hold, three-way calling, intercom, direct connection, call restriction, and call pickup. (29 CPUC 2d at 385.)

be determined on a customer-specific basis, because a customer may not use a monopoly building block, such as switched access, in every case. Based on their approach to imputation, Pacific and GTEC concur that the contract price should recover at least the LRIC for the total service plus the contribution from any monopoly building block involved in providing the service.

In keeping with our adopted price floors, prices under the LECs' contracts must equal or exceed the LRICs (or DECs if they are lower) of each rate element of the contract services, and prices for contracts involving bundled services which include monopoly building blocks must meet all of our adopted imputation tests. Obviously, the LEC must have filed rate element LRICs before it can file contracts subject to LRIC price floors.

We will allow two exceptions to our price floor rule so that LECs will have an ability to match in a fair way the offerings of competitors. First, in order to compete, particularly for large-volume business customers, Pacific and GTEC may use either servicewide or customer-specific LRICs for setting contract price floors. However, customer-specific LRICs must be calculated on an appropriate uniform per-unit basis (e.g., per-foot, per-line). The LEC must establish per-unit LRICs in a compliance filing setting forth the calculation and cost basis for the unit price. The LEC may then apply the unit price to the appropriate characteristic of the customer (e.g., distance from central office, number of lines) to establish customer-specific LRICs for use in calculating price floors for individual contracts.

Second, LECs may in appropriate circumstances offer an average rate that may be less than some of the LRICs of included rate elements, provided that the average rate exceeds the customer-specific cost developed by applying either the servicewide or the particular customer's pattern of use, or profile, to the LRICs for each rate element.

This option may be illustrated with a simplified example for DDD. A customer may want a single rate for all daytime DDD, and the negotiated rate may be less than the LRICs for some mileage bands, but greater than the LRICs for others. The contract may be approved if the LEC can demonstrate that the flat rate exceeds the weighted average LRIC for the service. The weighted average LRIC can be developed by multiplying the recorded percentage distribution of calls to each mileage band by the LRIC for the mileage band (the servicewide profile), or by multiplying the particular customer's recorded calling patterns to each mileage band (the customer's profile) by the corresponding LRIC for the mileage band.

This calculation may be considerably more complicated if a customer wants a single rate for all DDD calling, since the call distribution and corresponding LRICs would need to be analyzed for each time period and mileage band and for the first minute and additional minutes.

Our average rate approach resembles Pacific's ARPM proposal, but it is much less subject to manipulation by the LEC. The LRICs for the rate elements will be filed and will be the same for contracts and corresponding tariff services. To smooth the way for contracts containing average rates, we will require Pacific and GTEC to submit, as part of implementation, a compliance filing containing appropriate servicewide profile information. This servicewide profile information will be updated in annual filings. For DDD calling, to continue our example, the LEC should submit information on call distribution by time of day and mileage band for the first minute and additional minutes. If an average rate is based on the particular customer's profile, the LEC must submit information sufficient for CACD to verify the customer profile that underlies the claimed cost. We delegate to CACD the authority to develop the detailed requirements for these filings.

We believe that these options will allow the LECs to compete fairly with IECs while guarding against below-cost pricing.

LECs other than Pacific and GTEC may also wish to execute contracts to combat bypass of their networks. Since they have not embraced NRF or submitted a NRF implementation rate design, the other LECs must satisfy the requirements of G.O. 96-A for contracts, in particular the preapproval requirement for nongovernmental contracts. Pacific's LRICs may serve as a proxy for the other LECs' LRICs for the purpose of evaluating the reasonableness of a contract floor price. However, the use of Pacific's LRICs is permitted only if the other LEC provides identical service by concurring in Pacific's comparable tariff schedule.

3. Modification of Contract Guidelines

In this rate design proceeding, we will not completely revise G.O. 96-A or prior decisions affecting contracts under G.O. 96-A. However, some changes to both existing contract guidelines and G.O. 96-A are necessary to implement this decision. In particular, the Phase I settlement contains contract guidelines modifying G.O. 96-A. (29 CPUC2d at 390-391.) Our order today expands the list of competitive services and adopts contract procedures appropriate to a more competitive industry. The provisions of today's order modify and supersede any conflicting provisions in D.88-09-059.

We have already decided two issues in a way that conflicts with and therefore supersedes the provisions of D.88-09-059. First, we permit the LECs to contract for all Category II services, including MTS, WATS, and 800 services. In addition, our price floor standard requiring imputation of the tariff rate for monopoly building blocks and LRICs for competitive components replaces the prior standard of "1MB plus EUCL" ordered in D.88-09-059 for Centrex access line contracts (Id. at 390).

In addition to the changes described above, we adopt the following changes to G.O. 96-A and the contract guidelines adopted in the Phase I Decision. To the extent that these procedures are inconsistent with prior decisions in this area, the contract procedures described in those decisions are superseded. The following decisions, among others, may contain passages superseded by today's order: D.87-12-027, D.88-09-059, D.90-04-031, D.90-05-038, D.91-01-018, and D.91-07-010 (rehearing granted in D.91-11-016).

a. "Unusual and Exceptional" Circumstances

Pacific and GTEC propose to amend the contracting procedure to speed up approval of contracts. The contract guidelines adopted as part of the Phase I settlement require a showing of "unusual and exceptional" circumstances and a Commission resolution approving the contract before a customer-specific contract becomes effective. (29 CPUC2d at 390-391.)

Pacific and GTEC suggest that the requirement of unusual and exceptional circumstances would be satisfied by an assertion that "the customer is vulnerable to competitive service offering."

Whenever an LEC negotiates a contract, its management presumably believes that without the contract the LEC would lose the customer, and consequently all associated revenue and contribution, to the competition. While the contract rate may produce lower revenues than if the LEC provided the service under the appropriate tariff, it presumably will result in greater net revenues than losing the customer to the competition. In the context of expanded competition, an assertion of unusual and exceptional circumstances will add little information to our review. Furthermore, we have adopted appropriate price floors and imputation tests for LEC contract prices to guard against subsidization of competitive offerings. Thus, no good purpose is served by requiring the LEC to demonstrate "unusual and exceptional

circumstances" to justify a contract. This requirement of D.88-09-059 is eliminated.

b. Express Contract Procedure

DRA proposes an express contract procedure that would allow contracts with nongovernmental entities to become effective 14 days after they are filed with the Commission, unless rejected by CACD within that period. Only contracts for Category II services would be eligible for this procedure. Although parties would have the opportunity to file protests within 10 days, merely filing a protest would not prevent performance under the contract unless CACD acted on the basis of the protest to reject the contract.

DRA's proposal provides a way for us to review the LECs' contracts for compliance with our policies, and thus to ensure that the contracts' rates are just and reasonable (PU Code §§ 451, 454(a)), without unduly delaying the effectiveness of the contract. Effective on January 1, 1995, we will authorize the suggested express procedure for our review of all nongovernmental contracts[56] that include Category II services at other than the tariff rate. The express procedure is appropriate for contracts that include both Category II and III services,[57] and for contracts that combine Category II or III services with Category I services at the tariff rate.

The compressed schedule for review under the express procedure does not allow time for us to reject a proposed contract by resolution. We therefore authorize CACD to review filed

56 Governmental contracts for Category II services continue to be subject to the procedures of D.91-07-010, 40 CPUC 2d 675.

57 Res. T-15139 (March 24, 1993), modified by D.93-07-016, removed the preapproval requirement and authorized substantial deviations from G.O. 96-A's requirements for contracts involving exclusively Category III services.

contracts for compliance with our stated requirements and pricing and other policies, and, if appropriate, to reject a contract by letter, which may be transmitted by facsimile. CACD's role in this review is a ministerial one of ensuring that the contract conforms to our requirements and policies. CACD's letter rejecting a contract must clearly state the reason for the rejection. After receiving a rejection letter, the LEC may address the points raised in the letter and refile the contract.

For contracts that present novel issues or that would require CACD to exercise a degree of judgment inconsistent with its ministerial role, CACD may also provisionally reject a contract to prevent the contract from becoming effective in 14 days, to allow time for CACD to prepare a resolution with its recommendation for our consideration and decision.

The key to the express procedure is that filed contracts automatically become effective 14 days after filling, unless CACD acts to reject the contract. This reverses and is an exception to the usual treatment of contracts under G.O. 96-A, which requires the Commission's explicit approval before a contract may take effect.

Because of the limited time for review under the express procedure, contracts that contain average rates justified by weighted average LRICs based on the particular customer's profile (costs that are presumably lower than weighted average LRICs derived from the servicewide profile) will be reviewed under the ordinary G.O. 96-A procedures, rather than the express procedure. We recognize that these are typically contracts for highly competitive services, and we will complete our review as expeditiously as possible. Contracts containing average rates that are equal to or above the weighted average LRICs derived from the servicewide profile are eligible for the express procedure.

A primary purpose of CACD's review is to verify that contract prices are not below the appropriate price floors. As a

further deterrent to below-cost contract pricing, we adopt a revision of the penalty adopted in D.91-07-010, 40 CPUC 2d 675. If the contract price is less than the applicable price floor, we may require the offending LEC to pay a penalty of $10,000 or twice the difference between the applicable LRIC and the contract revenue over the life of the contract, whichever is greater, and a $2,000 fine for each occurrence, to the state general fund. If we find that an LEC is engaging in a pattern of below-cost pricing, its authority to contract at other than tariff rates may be suspended. (Id. at 695-696.)

In addition, if we determine that the contract's prices are lower than the appropriate price floor or that included Category I services are priced at less than the tariff rate, we may invalidate the contract rate, require the contract to be amended to charge the appropriate rate, and impose appropriate penalties; all of these actions may be made retroactive to the effective date of the contract.

As we recently stated in another context, we are determined not to allow our procedures and proceedings to be misused by competitors. (Order Instituting Investigation 94-04-004, slip op. at p. 3.) The potential for this misuse rises as competition increases, and our sensitivity to this potential must escalate correspondingly. The ability to protest contract and tariff filings carries this potential for competitive abuse, and we warn competitors against filing protests merely to seek a competitive advantage. Any protest that appears to have been filed to gain a competitive advantage, rather than to inform the Commission of a legitimate issue of public concern, will be disregarded and summarily dismissed. In addition, only a customer who alleges that it is similarly situated to the contract customer and has been denied the contract's rates by the LEC may protest on the ground that prices under a contract are discriminatory in violation of § 453(a).

c. Term of Contract

DRA recommends that we limit the term of these contracts to 10 years or less. Because of the protections offered by the price floors, ratepayers bear little risk from these contracts. In this rapidly changing industry, we suspect that few contracts will have terms approaching ten years. More fundamentally, the parties entering into contracts should be free to negotiate contract lengths that they believe are appropriate to their circumstances. We will not set a limit on the terms of these contracts.

d. Tracking Reports

DRA proposes to require the LEC to file annual profitability tracking reports, which compare each contract's total revenues and the total incremental cost of each product using the Commission's adopted cost methodology. This information is already contained in the routine NRF monitoring reports submitted by Pacific and GTEC, and no additional reports are necessary.

e. Tariffed List of Contracts

In the Phase I decision, we required the LECs to establish a tariff schedule to list all contracts entered into as a result of the Phase I settlement and D.87-12-027. (29 CPUC2d at 390.) We no longer see a need for a tariffed listing of contracts, and the list may grow rather long as a result of this decision and our adoption of the express contract procedure. The LECs are no longer required to list in their tariffs contracts entered into on or after the effective date of this decision. The existing tariff list should continue to be maintained for contracts entered into before the effective date of this decision. As these contracts expire, the list will grow shorter, and eventually this tariff may be eliminated.

f. Public Disclosure Requirements

Rather than publicly disclose the terms of contracts as required by G.O. 96-A, the LECs propose to shield the customer's name, contract prices, terms, and conditions from public disclosure. Only broadly aggregated information, such as total contract revenue for all usage services, would be publicly released. Pacific hastens to add that all contract information would be available to the Commission, its staff, and interested parties under an appropriate nondisclosure agreement.

We believe that public disclosure of contract terms is both legally required and crucial to our goal of relying on market forces, rather than regulation, to restrain any incentive the LECs may have to engage in anticompetitive behavior. The public availability of contract information is also essential if we are to meet our statutory duties to ensure that rates are not discriminatory.

(1) Statutory Requirements

To a great degree, we are required by statute to disclose the contract terms the LECs ask us to shield from public disclosure. PU Code § 489(a) states, in pertinent part:

> The Commission shall, by rule or order, require every public utility...to file with the commission within the time and in the form as the commission designates, and to print and keep open to public inspection,...all...contracts...which in any manner affect or relate to rates,...classifications, or service.

The statute unambiguously requires that contracts in any manner related to rates and service must be open to public inspection.[58] This requirement also means that these contracts cannot be submitted in confidence under the provisions of § 583, which do not apply to "matters specifically required to be open to public inspection by this part" (Division 1, Part 1 of the PU Code), which includes § 489. (See D.87-05-046, 24 CPUC2d 231, 247-248, modifying D.87-03-044, 24 CPUC 2d 46. Cf. the Public Records Act (Government Code § 6250 et seq.), which requires state agencies to make records "relating to the conduct of the public's business" open to public inspection, with limited exceptions.)

(2) Encouragement of Competition

Apart from the legal requirements, we conclude that public availability of the terms of contracts will promote competition. Markets thrive when the prices that buyers and sellers arrive at are widely known, and suppressing price information will lead to less efficient markets. In addition, we question whether concealing the prices contained in contracts filed with us would be effective; we suspect that competitors will be active and successful in obtaining this information directly from the customers and from other sources.

(3) Preventing Unlawful Price Discrimination

Making contract information available to the public will also serve as a safeguard against unlawful price discrimination by the LECs. As we noted earlier, contracting with individual customers at rates that deviate from those available under the tariffs raises the issue of whether such contracts

58 Under the statute's syntax, the utility is required to keep its contracts open to public inspection. If the contracts are available for public review at the utility's offices, it makes little sense not to make them available for similar public review at the Commission's offices.

violate the nondiscrimination provisions of § 453(a). Courts reviewing this issue under statutes similar to § 453 have concluded that such contracts are permissible if the rates under the contract are made available to any similarly situated customer willing to meet the contract's terms. (Sea-Land Service, Inc. v. ICC, 738 F2d 1311, 1317 (D.C. Cir. 1984); MCI Telecommunications Corp. v. FCC, 917 F2d 30, 38 (D.C. Cir. 1990).)

We will honor the requirement that rates under contracts must be made available to any similarly situated customer willing to abide by the contract's terms. In the context of expanded competition, however, we believe that this requirement will rarely need to be enforced. Rates and services under negotiated contracts with individual customers are designed to meet the needs of that customer, and it will be difficult for a protesting customer to demonstrate that it is sufficiently similarly situated to invoke § 453's nondiscrimination provisions. Numerous characteristics of a particular customer--volume, calling patterns, cost of negotation, etc.--could be sufficient to distinguish one customer from another.

In addition, increased competition should make this restriction unnecessary. A customer who believes someone else is getting a better deal can exert its bargaining power to try to get the same deal from the utility, or it may defect to a competitor for the service. Competitors eager to increase their market share should be quick to offer the LEC's prices to similarly situated customers. Because deviations from the tariff rates will cost them revenues, the LECs have an incentive not to negotiate contracts unless competitive conditions compel it. In this sense, every customer who is similarly situated in terms of bargaining power and competitive conditions will receive the same contract rate.

But competition can have the effect of countering any discriminatory treatment only if pertinent

information is widely available. For this additional reason, we favor public disclosure of contracts.

(4) Exceptions

If the parties are fully aware that the terms of their contracts will be publicly available, we are confident that they will be able to negotiate agreements that do not contain commercially sensitive information. In the event that reference to commercially sensitive information is unavoidable, the LEC may file a motion in this docket (or in any successor docket the Commission designates) for leave to file the advice letter submitting the contract with such information deleted (the copy of the contract provided to CACD for its use must include all information, without exception). The motion must clearly demonstrate that the customer or the LEC will suffer a substantial business disadvantage if the information is publicly available. We will grant such motions only if we are convinced that our overriding obligation to further the public interest compels such a result, and that our general authority to do all things "necessary and convenient" in the exercise of our jurisdiction (PU Code § 701) is sufficient under the circumstances to justify an exception to the clear requirements of § 489. The contract advice letter will not be filed unless and until the motion is granted. If the motion is denied in whole or in part, the LEC may file the contract only if the deleted material is included to conform with the ruling on the motion.

In addition, we recognize that some contract customers may not want their names to be made publicly available in connection with specific contract terms. The identity of a specific customer is less central to our competitive goals than the prices of the contract services. We will honor customers' requests for privacy and permit utilities, at the customer's request, to file contracts with the customer's name omitted. Allowing utilities to remove customers' names from filed contracts at the

customer's request is within the authority § 489(a) grants us to specify the form of filed contracts.

(5) Workpapers and Cost Documentation

CACD will also need other additional information to review the contract advice letter, including a network diagram of the service (see Figure X-1), a list of services provided under the contract, the price floor and ceiling applicable to each service, the price for each service, and appropriate cost or other information supporting the price floor calculation. For contracts containing Category II services with monopoly building blocks, the information should be sufficient to allow CACD to verify that the contract prices meet all three imputation tests. The additional information needed by CACD does not fall within the scope of § 489's requirements (except to the extent that it duplicates information stated in the contract), and thus it may be submitted in confidence under PU Code § 583. Parties other than DRA must enter into protective agreements to obtain such information.

Due to the short time available for review of contracts filed under the express procedure, competitors and other interested parties who have executed appropriate protective agreements may present the LEC with a standing request to be provided with workpapers and cost documentation when advice letters submitting express procedure contracts are served on them. The LECs shall honor these requests.

g. Changes to G.O. 96-A

The portions of G.O. 96-A which govern a utility's contracts for service should be revised to be consistent with the above provisions. The appropriate revisions to G.O. 96-A are stated in Appendix G.

In D.93-02-010, we granted AT&T-C's request to relax G.O. 96-A's advice letter requirements for filing rate revisions for competitive services. It is not appropriate to grant the NRF LECs the same flexibility we accorded AT&T-C because they are

regulated differently.[59] Therefore, the NRF LECs will be governed by the terms of G.O. 96-A that are shown in Appendix G.

4. Contract Modifications

a. Minor Modifications

In recent resolutions authorizing telecommunications contracts, we have allowed contract modifications that do not materially change the services provided under the contract to become effective on CACD's approval. (E.g., Res. T-15521 (April 6, 1994), Res. T-15520 (May 25, 1994).) We will continue this practice for contracts submitted under the express contract procedure. Because these contracts will ordinarily not be the subject of a Commission resolution, we will take the opportunity in this order to grant CACD the authority to approve modifications that do not materially change the contracts.

In particular, CACD is authorized to approve contract modifications when the modifications do not reduce the revenue-cost ratio of the contract; when the modifications add or substitute services from the same tariff schedule that offers the services provided under the original contract; and when the modifications make other immaterial changes that do not violate or change any Commission decisions or resolutions.

Any modifications that materially change the services provided under the contract must be filed and reviewed under the procedure that would apply if the modified contract had been newly proposed, i.e., under the express contract procedure or by a G.O. 96-A advice letter.

59 AT&T-C is a major competitor in the IEC market, whereas the LECs continue to enjoy monopoly status in the bulk of their enterprises. While AT&T-C is also subject to a LRIC price floor, its proposals to increase prices for existing services are not subject to price ceiling limitations.

b. "Fresh Look" Modifications

After the rate changes resulting from this decision, some customers who now have contracts with the LECs may find that the tariff rates for the services provided under the contract are cheaper than the contract rates. This possibility raises the issue of whether we should allow the customers to terminate or renegotiate their existing contracts without penalty.

In D.93-06-032, modified by D.93-06-077, we approved a settlement that allowed Pacific, during a four-month period, to execute contracts for MTS, WATS, or 800 services to deter bypass of the public switched network. Under the provisions of the approved settlement, customers entering into these contracts would have 120 days after the implementation date of IRD (the "Fresh Look" period) to terminate the contract without any penalties or liabilities. Consistent with D.93-06-032, customers with these "Fresh Look" contracts may terminate their contracts after implementation without penalty.

On the other hand, we find no compelling reason to excuse other customers who negotiated contracts from abiding by the terms of their contracts. These contracts were freely negotiated by commercially sophisticated parties, usually for the sole purpose of obtaining service at less than the tariff rate that would otherwise apply. These parties could have reduced the risk that tariff rates would later be lower than the contract rate by negotiating a short contract term or by including explicit renegotiation or termination provisions. They entered into these contracts on the basis of their business judgment that they would receive lower rates overall under the contract. The fact that the judgment may turn out to be wrong is an ordinary risk inherent to business or any other human endeavor.

Thus, we will apply the principle that parties should honor the terms of their contracts. We will not allow a "Fresh Look" for any contracts other than those contemplated in D.93-06-032. The LECs remain free to renegotiate these contracts if they choose, but we will not account for any such renegotiations in the revenue rebalancing.